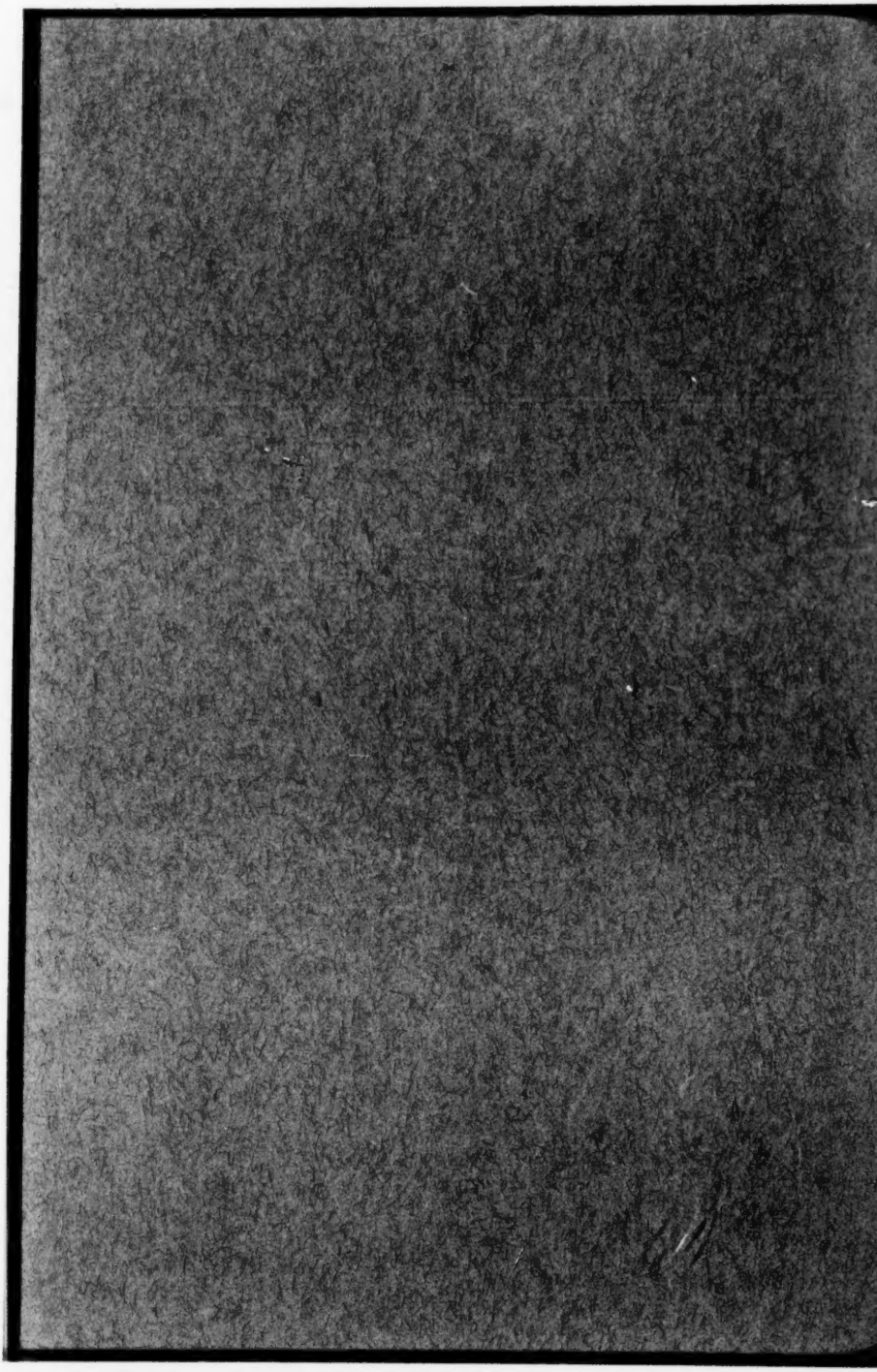

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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 907

THE CITIZENS NATIONAL BANK OF KIRKSVILLE, MISSOURI, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 46–53) is reported in 122 F. (2d) 1011. The opinion of the Board of Tax Appeals (R. 30–35) is reported in 42 B. T. A. 539.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered October 16, 1941 (R. 54). A petition for rehearing (R. 55–60) was denied by the court on November 4, 1941 (R. 61). The petition for a

writ of certiorari was filed on January 28, 1942. The jurisdiction of this Court is invoked under section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

Taxpayer corporation in 1920 purchased from A his life interest in real estate, undertaking to pay A $200 a month for life. Shortly thereafter taxpayer purchased the remainder from B. The questions are:

1. Whether the taxpayer may deduct from its gross income for 1936 the amounts paid to A in that year, as a business expense, in amortization of the cost of the property interest acquired from A.

2. Whether the taxpayer may deduct those amounts as a loss sustained during the taxable year, A having in 1933 outlived his 1920 life expectancy.

3. Whether the taxpayer may deduct as a loss such part of the amounts paid to A in 1936 as represents the original interest of A in a building on the land in question which was demolished by taxpayer in 1923.

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

STATEMENT

A stipulation of facts entered into by the parties (R. 17–26) was adopted by the Board of Tax Appeals (R. 27–30). The facts may be summarized as follows from the stipulation:

Petitioner is a Missouri corporation engaged in a general banking business (R. 17). From the time of its organization in 1906 until the spring of 1912 the taxpayer occupied the first floor of a building owned by William T. Baird (R. 17–18, 20). Baird died in 1912, leaving a will by which he devised the

property to his son, Frank Baird, for life, with remainder in fee to the testator's daughter, Alta Baird Belshe (R. 18). The will required Frank Baird to pay the cost of repairs and insurance on the bank building (R. 22). It also provided that in the event of destruction of the building by fire or tornado Mrs. Belshe should have the right to rebuild, using the insurance money for that purpose, and would thereafter own the property outright by paying Frank Baird an amount monthly equal to the net amount he had been realizing as rental of the property (R. 18, 22).

From the death of William Baird in 1912 to April 21, 1920, the taxpayer paid rent for its occupancy to Frank Baird (R. 18). Early in 1920 petitioner found that the building which it occupied was old and greatly in need of repair (R. 18). It entered into negotiations with Frank Baird and on April 21, 1920, acquired the latter's life interest in the property (R. 18, 24). Contemporaneously with this conveyance Frank Baird and petitioner entered into an agreement which provided that Baird should paint and decorate the hallway of the building, repair the roof, keep the building insured in the amount for which it was then insured, and keep the roof in repair, during the life of the agreement (R. 19, 25). In consideration, the taxpayer agreed to pay Frank Baird $200 a month for life (R. 18, 25). The agreement further provided that if the bank building should become untenantable the obligation of the taxpayer

to make monthly payments would cease, and that if the building should be destroyed by fire or storm the rights and liabilities of the taxpayer would cease and the parties thereafter would stand in the same position as if the agreement had not been made (R. 19, 25).

Thereafter, on August 17, 1920, petitioner acquired the remainder interest of Mrs. Belshe for $10,000 (R. 20, 25–26). This amount was carried on petitioner's books as a part of the cost of the building; since petitioner acquired the interests of Frank Baird and Mrs. Belshe it has carried the land and building as a capital asset on its balance sheet. The taxpayer has reported as part of its gross income all rents received by it from the part of the bank building not occupied by petitioner. The expenses of the building, except such as were met by Frank Baird under his agreement with the taxpayer, were borne by petitioner. (R. 20.)

On December 4, 1920, the taxpayer set aside $5,000 to a fund for building improvement. Additional sums in like amount were set aside in 1921 and 1922 for the same purpose. On January 10, 1923, the taxpayer authorized the making of repairs and alterations in the bank building and the installation of new fixtures. It was subsequently discovered that, owing to the damaged condition of the foundation of the building and of one wall, it was more practical to raze the building. A new structure was then erected at a cost to petitioner of $43,096.96. The taxpayer has occupied the

first floor of the new building since its completion. (R. 20.)

Petitioner paid Frank Baird $200 a month in accordance with their agreement of April 21, 1920, from May of that year to and including the month of December 1936 (R. 20). During the same period Frank Baird paid on an average $33.84 per annum for insurance on the building, as required by the agreement of 1920 (R. 20–21).

It was further stipulated by the parties, subject to objection by the Commissioner on the ground of irrelevance, that on April 21, 1920, Frank Baird was 61 years of age and had a life expectancy on that date, based on American experience tables of mortality, of 13.47 years; that the value of the annuity contracted to be paid him was $21,918.37, computed as of April 21, 1920;[1] that the fair market value of the land and building in question on April 21, 1920, was $35,000, and that the fair market value of the land alone was $6,250 (R. 21). Taxpayer deducted on its 1936 income-tax return the sum of $2,400 which it had paid to Frank Baird (R. 19). This deduction was disallowed by the Commissioner of Internal Revenue, and a deficiency was accordingly determined (R. 6–9, 19). The Commissioner's determination was sustained by the Board of Tax Appeals (R. 26–35); and the decision of the Board was affirmed by the Cir-

[1] This calculation was based on the payment of $200 per month less a deduction of $2.82 for the insurance payments which Frank Baird was required to make.

cuit Court of Appeals for the Eighth Circuit (R. 46–53).

ARGUMENT

The Commissioner of Internal Revenue, the Board of Tax Appeals, and the court below all treated the transaction of April 21, 1920, between petitioner and Frank Baird as a step in the purchase by petitioner of the bank building and land; they considered petitioner's outlay of consideration a capital expenditure to acquire a capital asset. Stipulation for payment of the purchase price in instalments does not alter the nature of the transaction. Gain or loss would only be recognized on a final disposition of the property acquired, under sections 111–113 of the Revenue Act of 1936; the transaction would not have income-tax consequences until both sale price and cost were ascertained, and then would be regarded as resulting only in capital gain or loss, if any. This view and the corresponding disposition of petitioner's case below is clearly correct, and calls for no reexamination by this Court.

1. Petitioner claims the right to deduct payments to Frank Baird in 1936 under section 23 (a) of the Revenue Act, on the theory of amortizing the cost of the acquisition of Baird's property interest. The circuit court of appeals cases cited by petitioner (Pet. 8–9) in support of the application of such a theory to the present case are not in point, and therefore present no conflict;

in each the taxpayer was holder of a *leasehold* estate, with the cost of the term being in consequence returnable by annual deductions from gross income. Here petitioner's payments were made toward the acquisition of a fee simple in possession, so that the *rationale* for amortization is absent. It is not material for purposes of income-tax law whether or not there was a technical merger of estates in the taxpayer after it acquired the remainder interest in the property from Mrs. Belshe in August 1920.

No conflict exists, as alleged (Pet. 8), with *Duffy* v. *Central R. R.*, 268 U. S. 55. The Court there held that expenditures by a corporate lessee for additions to the leased property (required by the lease to be made) were not deductible as a business expense, stating in addition only that annual deductions for depreciation and exhaustion of the capital improvements made could be taken from year to year. 268 U. S. at 64. Obviously, the taxpayer in the present case has not calculated its claim for deduction in terms of depreciation in 1936 on the bank building erected by it in 1923. Cf. section 23 (l) of the Revenue Act of 1936.

Petitioner attacks (Pet. 7–8) the holding of the court below (R. 50–51) that the provisions of section 23 (a) dealing with rentals and similar payments by implication exclude the possibility of the deduction claimed; petitioner asserts that the provisions of the earlier portion of the subsection do not contain the restrictions as to title particular

to rents, and that its claim should be allowed as a deduction under those latter provisions. This contention of the taxpayer is contradicted fundamentally by the basis of petitioner's claim, which rests for its theory on the circuit court of appeals cases cited at pages 8 and 9 of the petition for certiorari and referred to above at page 7. Cf. Art. 23 (a)–10, Treasury Regulations 94 (1936). From the terms of section 23 (a) it is clear that the payments to Frank Baird in 1936 were not deductible as rent or similar payments, and, impliedly, not at all. Even if, as petitioner contends, it is not *thereby* barred from taking a deduction pursuant to the initial provision of section 23 (a), its claim must fail because the payments to Baird constituted not a business expense but a capital expenditure. Cf. *Duffy* v. *Central R. R.*, 268 U. S. 55.

2. The taxpayer additionally contends that it should be permitted to deduct the $2,400 paid to Frank Baird in 1936 as a loss sustained during the taxable year, under section 23 (f) of the Revenue Act, since Baird had in 1933 outlived his life expectancy, calculated as of April 21, 1920. This position is untenable in view of the *capital* nature of the transaction between petitioner and Baird; petitioner was not engaged in the commercial writing of annuities in 1920 but simply purchased an interest in property on a plan of deferred payments. Any loss that might result from an unexpectedly large total of purchase payments would

only be deductible as a capital loss on sale of the property, if the sale price were exceeded by the discounted cost. See *Steinbach Kresge Co.* v. *Sturgess,* 33 F. Supp. 897, 898–899 (D. N. J.).

Petitioner's claim (Pet. 11–12) that the decision below conflicts with *Commissioner* v. *John C. Moore Corp.,* 42 F. (2d) 186 (C. C. A. 2d), is insubstantial. The taxpayer there had purchased property from A in return for payments to A of $10,000 a year for life, and the court held that the corporation taxpayer could deduct *as interest paid* the difference on each annual instalment between $10,000 and the discounted value of the instalment at the time of the purchase. While the opinion contains statements *obiter* that are inconsistent with the decision of the court below in this case, we think the *dicta* are plainly unsound regardless of the status of the decision in the *Moore* case. See *Steinbach Kresge Co.* v. *Sturgess, supra.*

3. Finally, petitioner urges that if it is not entitled to deduct the full amount paid to Frank Baird in 1936 it should be permitted to deduct as a loss in 1936 that portion ($1,971.44) of the $2,400 which represents the original interest of Baird in the building that was razed in 1923 by taxpayer. Petitioner relies for authority on *Eckert* v. *Burnet,* 283 U. S. 140, and *Helvering* v. *Price,* 309 U. S. 409, and asserts a conflict with decisions in four circuit courts of appeals. The rule of the *Eckert* case, that a taxpayer who gives

his note in exchange for an obligation known to be worthless sustains no loss until he pays the note, is obviously inapplicable to the situation in the present case; decision in the other cases cited by petitioner stemmed from *Eckert* v. *Burnet, supra,* with the result that they are no more apposite here. It seems clear that if any loss was sustained by the taxpayer from demolition of the old bank building it occurred in 1923 and was deductible in that year only. *Union Bed & Spring Co.* v. *Commissioner,* 39 F. (2d) 383 (C. C. A. 7th); *Louis Pizitz Dry Goods Co.,* 22 B. T. A. 161.

CONCLUSION

The decision of the Circuit Court of Appeals is correct and presents no conflict of decisions. It is therefore respectfully submitted that the petition should be denied.

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MARCH 1942.

U. S. GOVERNMENT PRINTING OFFICE: 1942